

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE
MINUTES OF THE AUGUST 16, 2006 PENSION BOARD MEETING

1. Call to Order

Vice Chairman John Martin called the meeting to order at 8:37 a.m. in the Gordon Park Pavilion at 2828 North Humboldt Boulevard, Milwaukee, Wisconsin 53212.

2. Roll Call

Members Present:

Linda Bedford
Donald Cohen
John Martin
Marilyn Mayr
John Parish
Dean Roepke
Thomas Weber

Members Excused:

Michael Ostermeyer

Others Present:

Mark Grady, Principal Assistant Corporation Counsel
Jack Hohrein, ERS Manager and Pension Board Secretary
Gordon Mueller, Fiscal Officer
Vivian Aikin, ERS Administrative Specialist
Ann To, ERS Administrative Specialist
Veronica Britt, ERS Coordinator
Steven Huff, Reinhart Boerner Van Deuren s.c.
Leigh Riley, Foley & Lardner LLP
Brad Blalock, Mercer Investment Consulting
Kristin Finney-Cooke, Mercer Investment Consulting
Barrett Rodriguez, Vitech Systems
Scott Larson, Vitech Systems
Wayne Shiu, Vitech Systems
Matt Lehan, Vitech Systems
Chris Ryder, Capital Guardian Trust Company
Tom Hancock, GMO, LLC
Carolyn Nelson, GMO, LLC
Nancy Beck-Metz, Retiree
Ken Loeffel, Retiree
Michael Howden, Retiree
Florence Ignarski, Retiree

3. Approval of Minutes of July 19, 2006 Meeting

The Board reviewed and unanimously approved the minutes of the July 19, 2006 Pension Board meeting. Motion by Mr. Cohen, seconded by Ms. Mayr.

4. Report of Retirement Systems Manager

(a) Ratification of Retirements Granted

Mr. Hohrein presented the schedule of Retirements Granted for the prior month's retirements and asked the Board to review them. He reported that there were \$391,000 in backDROP payments.

The Board unanimously accepted the Retirements Granted report. Motion by Mr. Cohen, seconded by Mr. Parish.

Mr. Hohrein also informed the Board that ERS should expect an increase in retirements by the end of 2006 due to perceived layoffs and new collective bargaining agreements. Dr. Roepke inquired as to the impact of the retirements on ERS's financial status. Mr. Hohrein stated his belief that approximately 30 additional members would retire in 2006. Accordingly, his rough estimate is that ERS would pay an additional \$780,000 in annual benefits for pensions starting in 2007. This estimate did not include backDROP payments.

(b) Report on Waivers

Mr. Hohrein reported that no new waivers had been submitted to the Retirement Office.

(c) Report on ADR Earnings and Recalculations

Mr. Hohrein presented an update on issues regarding accidental disability retirement pensioners. He stated that the Retirement Office had received earnings information from one out-of-state pensioner. He also explained that the Retirement Office was requesting medical reports on the four accidental disability retirement pensioners who had not submitted financial information.

Mr. Hohrein reported on recalculations for disability retirees at age 62. He indicated that he was working with one ERS retiree who received an accidental overpayment from ERS. He stated that he plans to recover all overpaid funds from the retiree and he would report back to the Board regarding the status of this overpayment at a future Board meeting. Ms. Mayr expressed concern that ERS could experience overpayment

issues, similar to those faced by the City, and asked whether any system could prevent a recurrence of these problems. Mr. Hohrein explained that only two of the 160 accidental disability retirees require a recalculation of benefits at age 62. Mr. Martin asked whether the new software system would flag accidental disability retirement pensions that require recalculation. Mr. Hohrein indicated that Vitech is setting up dates as trigger points for recalculation in the new software system.

5. Report of the Retirement System Fiscal Officer

(a) Cash Liquidity Report

Mr. Mueller presented the cash liquidity report. He indicated that the cash requirement through the end of the year was \$10 million per month (September to December 2006) for a total of \$40 million. In response to a question from Mr. Hohrein, Mr. Mueller stated that ERS could absorb another 40 retirees by the end of 2006 because ERS has a two month cushion built into its reserve funds. Mr. Mueller noted that he will return at the December Pension Board meeting for 2007 cash requirements unless more funds are needed sooner.

In response to a question from Ms. Bedford, Mr. Mueller explained that Mellon invests the reserve funds in short term bond funds and money market funds. Ms. Bedford questioned whether it would be financially beneficial to leave more of the funds invested until ERS needs the funds to be paid out. Mr. Mueller indicated that the Retirement Office must sometimes rush to pay lump sums, which are paid at the end of the month. He also noted that the quarter lead time gives managers a better time frame to cash out the funds. Mr. Martin added that the Retirement Office is trying to refine the process of making requests for funds.

The Board unanimously agreed to withdraw \$40 million for its September, October, November and December 2006 liquidity needs at a rate of \$10 million per month. Motion by Mr. Weber, seconded by Mr. Parish.

Ms. Mayr observed, and Dr. Roepke and Mr. Blalock agreed, that drawing from managers also serves as a back door rebalancing process. Ms. Mayr questioned whether other actions should be taken to rebalance the portfolio. Mr. Blalock explained that other actions are being taken and that in fixed income investments, high yield portfolios have two parts: (1) medium grade and (2) low grade. He indicated that not much more can be done by ERS to balance between these components because it is counterproductive

to tell a manager of a fixed income block how to split investments between permitted components.

(b) Pension Board Annual Report

Mr. Mueller presented the ERS annual report. He indicated that Virchow, Krause & Co. LLP ("Virchow Krause") approved the annual report and will issue a clean opinion once the Board approves the annual report.

In response to a question raised by Ms. Mayr regarding the rate of return on investment assets in the Financial Highlights Section, the Board discussed the appropriate rate of return. The Financial Highlights Section reports the rate of return at 9.5%, whereas other percentage returns discussed by the Board were lower than 9.5%. The Board agreed that the precise nature of the percentage return as calculated by the investment consultant, as well as the percentage return calculated and used by the respective actuary for purposes of the funding calculation, should be carefully described in the annual report. Mr. Martin suggested that Mr. Mueller discuss with Virchow Krause the method of presentation of rates of return in the 2005 annual report. Mr. Mueller agreed to do so.

The Board then discussed typographical errors and other minor changes to be made to the annual report.

The Board unanimously agreed to approve the 2005 annual report after correction of typographical errors and with the proper method of presentation of rates of return in the annual report, after Mr. Mueller confirms the rate presentation with the auditing firm of Virchow Krause. Motion by Ms. Bedford, seconded by Mr. Parish.

6. Implementation of New Technology Software – Vitech Systems

(a) General Overview

Ms. To of Milwaukee County and Mr. Rodriguez of Vitech Systems presented a report to the Board regarding the V3 project status. They reported that the V3 project is currently in the fourth phase, the Solutions Design Phase. They explained that the Solutions Design Phase is approximately 65% completed. Specifically, they noted that the Conference Room Pilot (a demo of the V3 system) was held on May 2, 2006. Ms. To and Mr. Rodriguez stated that construction of flow charts outlining how work will be performed using V3 has been completed. They noted that future state meetings to review the work flows, elaborate on the future state process and answer questions have been held. They also

mentioned that all of the Business Process Mapping Documents have been turned over for the County's review.

Ms. To and Mr. Rodriguez reported that the Infrastructure phase was 95% complete. They indicated that the Infrastructure phase was behind schedule, but that the delay will not impact the V3 project completion.

Mr. Martin inquired whether the data conversion was on schedule. Mr. Rodriguez indicated that he was optimistic that the data conversion would proceed on schedule in September.

In their report, Ms. To and the Vitech representatives recommended that the County approve overtime for Retirement Office employees, reorganize the Retirement Office and add to the Retirement Office staff. Mr. Parish questioned whether progress had been made on implementing these recommendations. Mr. Hohrein indicated that the County had granted overtime for the Retirement Office. He also explained that the Retirement Office is trying to increase Bob Schupe's availability to help with the project. Mr. Hohrein reported that Veronica Britt was hired to replace Gloria Morris. He informed the Board that a project manager started on Monday, August 14, 2006, and that the new project manager will attend the September Board meeting. He also noted that the Retirement Office had lost an intern.

Mr. Rodriguez noted that Vitech will need to continue to work with Ceridian and that Ceridian has been cooperative to this point.

In response to a question raised by Mr. Martin, Mr. Rodriguez confirmed that the Genesys System was being used for the 1099 statements. Ms. To added that Ceridian will go live in 2006 and the Retirement Office will want to take advantage of all available capabilities through an interface with it. In response to a question from Ms. Mayr regarding for whom Ceridian works, Mr. Grady indicated that Ceridian works for the Department of Administrative Services, to which both IMSD and DHR report.

(b) Project Manager Update

Mr. Hohrein explained to the Board the process that had been followed in hiring the new project manager. He reported that a request for contract ("RFC") had been issued to select an independent contractor for the project manager. He noted that the following firms were contacted to respond to the RFC:

Strategem IT Consulting
Manpower Professional
Maximus
CDG and Associates
Global Insights, Inc.

Mr. Hohrein explained that none of the firms contacted submitted a contract or proposal. Although no responses were received, Mr. Hohrein reported that he had received resumes from Manpower Professional, CDG and Associates, Global Insights, Inc., Syslogic, Inc. and Compass Technology Services. Mr. Hohrein also stated that he had access to applications from the HRIS project manager selection process. After reviewing the resumes, Mr. Hohrein interviewed Lisa Alberte, Selisha Summerville, Tami Back and Donald Campbell (Compass Technology Services). He noted that Dr. Karen Jackson of the Department of Human Resources and Deborah Lewis and Hugh Morris, both of IMSD, also participated in some of the interviews.

Mr. Hohrein explained that one candidate was eliminated mainly because she had no pension experience and requested employee status at a higher salary than provided by the County's pay provisions for project managers.

Mr. Hohrein indicated that two candidates were working for firms that provided project management services. While both had pension system experience, their per hour costs were the highest of the four. Neither had a project management professional ("PMP") designation. Mr. Hohrein felt that neither candidate demonstrated the take-charge ability ERS was seeking.

Mr. Hohrein reported that Donald Campbell owns Compass Technology Services and holds a PMP designation. Although Mr. Campbell has no pension experience, he does have a long history of managing projects. Mr. Hohrein explained that Mr. Campbell demonstrated strong leadership and take-charge skills in his interview. In addition, Mr. Campbell's price per hour was the most reasonable of the final three independent contractors.

Mr. Hohrein concluded that Mr. Campbell was the right candidate so the Retirement Office offered the project management contract to him. He indicated that the other three County participants in the interview process agreed that Mr. Campbell is a well-qualified candidate.

In response to a question from Ms. Mayr, Mr. Grady stated that he confirmed Mr. Campbell's experience as an independent contractor. Dr. Roepke inquired regarding Mr. Campbell's beginning and end date.

Mr. Hohrein stated that he anticipated a project completion date in mid-2007, but that the contract would make Mr. Campbell available through February 2008 in case of delays. Mr. Hohrein advised that Mr. Campbell would provide nearly full-time availability to the Pension Board and ERS until completion of the project.

7. Investments

(a) Investment Manager Reports

(i) Capital Guardian Trust Company

Mr. Ryder addressed the Board on behalf of Capital Guardian Trust Company ("Capital Guardian"). He outlined Capital Guardian's four-step investment process, which includes a team of managers and rigorous risk control. Mr. Ryder reviewed ERS's portfolio asset mix. He informed the Board that ERS has \$84 million in international equity and \$58 million in international small cap equity investments.

Mr. Ryder presented the global market review for the year to date. He also highlighted ERS's 20 largest holdings, including Mizuho Financial Group, a Japanese Bank that went from ERS's 66th largest holding to its 9th largest holding, mainly due to Capital Guardian's favorable outlook for Japanese banks in general and expectations for Mizuho in particular.

In response to the Board's concern with regard to a multiple manager approach, Mr. Ryder explained that the managers bring the advantage of different perspectives and that they communicate often, making conference calls about twice a day and traveling together to discuss portfolios and meet with clients.

Mr. Grady inquired what Capital Guardian learned from its below average performance in 2003-2004. Mr. Ryder indicated that Capital Guardian is trying to balance global regional factors and sector factors. He expressed optimism for the long term return of small cap equities, even if the short term return is not as promising.

(ii) GMO, LLC

Mr. Hancock and Ms. Nelson made a presentation to the Board on behalf of GMO, LLC ("GMO"). The GMO representatives outlined their investment process, which aims to find high quality investments at low prices. They compared GMO's premium or

discount to the market premium or discount to illustrate the cost of high quality investments. They also reviewed the three components of ERS's portfolio: quality adjusted value (40%), intrinsic value (40%) and momentum (20%).

The GMO representatives presented the top 15 holdings as of July 31, 2006 and explained GMO's international intrinsic value strategy. Finally, they reviewed a representative portfolio breakdown and performance summary.

Dr. Roepke inquired why pharmaceuticals are out of favor. Mr. Hancock described the fear that generic drugs will replace drugs with expiring patents. He stated that the market does not see the next blockbuster drug coming along.

In response to a question from Mr. Weber, Mr. Hancock explained that Porsche's investment in Volkswagen is an institutional, opposed to family, position. He stated that Volkswagen will not likely be taken private because Bavaria holds a large position in Volkswagen and would probably object. In response to another question from Mr. Weber, Mr. Hancock stated that Porsche's positions in Volkswagen are so small that they will not control the outcome of votes.

(b) Mercer Report

(i) Quarterly Report

Mr. Blalock distributed the quarterly report for the second quarter of 2006. He described the market environment for the second quarter, stating that the economy had cooled due to higher interest rates. Mr. Blalock explained that the Federal Reserve had raised the short-term interest rate 25 basis points in both May and June due to increased concerns about inflation. He also discussed the performance of the domestic equities market, fixed income market, international equities market and other asset classes.

Mr. Blalock next addressed asset allocation for ERS and reviewed the current asset allocation versus the allocation policy. He compared the current and prior asset allocation.

Mr. Blalock also reviewed the investment manager performance for the second quarter. He indicated that ING, Loomis Sayles, EARNEST Partners and Reinhart & Mahoney performed well during

the quarter. He noted that Hotchkis & Wiley is currently on the watch list. Mr. Blalock reported that Ariel had a negative quarter with one stock falling 30% and generally performed in the bottom quartile. As previously decided by the Board, Mercer will be moving funds from Ariel to a new manager.

(ii) Flash Report

Ms. Finney-Cooke presented the flash report for July 2006. She indicated that ERS had an aggregate market value of approximately \$1.5 billion at the end of July. She noted that ERS experienced a 0.3% increase during July.

Ms. Finney-Cooke also reviewed market performance for July 2006. She explained that the large cap domestic equity market advanced 0.2% in July, while small cap equity market declined 3.3%. Also, value outperformed growth in the large and small cap arenas. She noted that international investment grade fixed income gained 1.4% during the month and high yield issues returned 1.1%, which was less than the broad market return.

Ms. Finney-Cooke reported on ERS's investment allocation. She indicated that ERS's allocation is, when compared to the policy, currently overweight in mid cap equity and high yield fixed income and underweight in core fixed income. Ms. Finney-Cooke suggested withdrawing \$7.3 million from Artisan Partners, \$6.4 million from Hotchkis & Wiley and \$6.3 million from Earnest Partners to meet ERS's cash needs for the next two months.

(c) AQR Contract Review

Ms. Riley reported that the Board is in negotiations with AQR Capital Management ("AQR") to serve as ERS's small cap manager. She explained that AQR offers its services through a partnership, and, therefore, ERS must purchase an interest in the partnership. Accordingly, she noted that the Board has a limited ability to negotiate the arrangement with AQR.

Ms. Riley outlined for the Board the terms and conditions of the partnership agreement. First, she stated that the general management fee is only a fraction of the fee ERS would incur because the partnership agreement contains many fees and expenses that will reduce investment return. Ms. Riley noted that AQR has withdrawal charges that it will not waive. In addition, she explained that ERS's withdrawals would be restricted to the last day of a calendar quarter and may be made only upon providing

30 days' advance notice. She also reported that AQR would be permitted to borrow money to leverage its investments, leaving ERS's assets at a greater risk of loss. She indicated a possibility that some of AQR's investments could result in unrelated business taxable income. Finally, Ms. Riley reported that AQR would not indemnify ERS for any losses which were the result of AQR's negligence or willful misconduct.

Ms. Mayr and Dr. Roepke raised concerns regarding the amount of risk ERS would face in contracting with AQR. The Board discussed the risk and options to minimize risk with Ms. Riley and Mr. Blalock.

The Board agreed to discontinue negotiations with AQR Capital Management and recommence the search for a small cap manager by resuming a comparative look at potential candidates other than AQR Capital Management, 7-0-1 with Mr. Martin abstaining. Motion by Ms. Mayr, seconded by Mr. Parish.

The Board then discussed the options for the cash delivery of fund proceeds from Ariel.

The Board unanimously agreed to authorize Mercer to negotiate cash delivery of fund proceeds from Ariel and reinvest the proceeds in a small cap index fund or an exchange-traded fund of the Russell 2000. Motion by Ms. Mayr, seconded by Dr. Roepke.

Ms. Mayr moved to analyze Integrity Asset Management, Opus Capital Management, Cook Moyer Taylor and Osprey Partners in a new small cap manager search. The motion, seconded by Dr. Roepke, failed 4-3, with Ms. Mayr, Dr. Roepke, Mr. Weber and Mr. Parish voting to approve and Mr. Cohen, Ms. Bedford and Mr. Martin dissenting.

Mr. Cohen moved to consider only Integrity Asset Management and Opus Capital Management in a new small cap manager search. The motion, seconded by Ms. Bedford, failed 2-5, with Mr. Cohen and Ms. Bedford voting to approve and Ms. Mayr, Dr. Roepke, Mr. Weber, Mr. Parish and Mr. Martin dissenting.

The Board voted 6-1, with Ms. Bedford dissenting, to reconsider the previous motion and analyze Integrity Asset Management, Opus Capital Management, Cook Moyer Taylor and Osprey in a new search for a small cap manager. Motion by Mr. Weber, seconded by Mr. Parish.

The Board discussed further action necessary to proceed with the new small cap manager search.

The Board unanimously agreed to have the Investment Committee review information regarding Integrity Asset Management, Opus Capital Management, Cook Moyer Taylor and Osprey Partners and bring a new recommendation to the Board. Motion by Mr. Cohen, seconded by Mr. Weber.

8. Closed Session

The Chairman stated that the Board could enter closed session for considering financial, medical, social or personal information, of which the Board has actual knowledge and which, if discussed in public, would be likely to have a substantial adverse effect upon the reputation of the person mentioned. For example, the Board may elect to enter closed session to discuss an individual's disability retirement application, which may entail discussions of, among other things, medical records of the applicant.

The Chairman also noted that the Board would enter closed session to confer with its legal counsel, who is rendering oral or written advice concerning strategy to be adopted with respect to litigation in which it is, or is likely to become, involved.

The Board unanimously agreed by roll call vote to enter closed session to consider Items 9 and 10.

9. Disability Application – Donna Brown-Wells (Accidental)

Upon returning to open session, the Board took the following action:

Consistent with the recommendation of the Medical Board, the Board unanimously agreed to deny the accidental disability application of Donna Brown-Wells. Motion by Dr. Roepke, seconded by Ms. Bedford.

10. Legal Update

Closed session litigation matters were discussed in closed session.

11. Administrative Matters

The Board indicated that any interested Board member is authorized to attend the International Foundation of Employee Benefit Plans' Scholar Session in Board Governance.

Dr. Roepke reported on the Certificate of Achievement in Public Plan Policy ("CAPPP") session in Chicago.

The Board unanimously agreed to add the election of a Chairman to the Agenda for the September 2006 Board meeting. Motion by Ms. Mayr, seconded by Mr. Weber.

12. Adjournment

The meeting adjourned at 2:05 p.m.

Submitted by Steven D. Huff,
Assistant Secretary to the Pension Board